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TAGS: EFIN ECON ELAB ALOW AR
SUBJECT: GOA Will Easily Cover its Financial Needs in
2006

¶1. (U) Sensitive but unclassified. Not for Internet distribution.

Summary

¶2. (SBU) The GOA will have no difficulty meeting its USD 11 billion in financing needs in 2006. Under a conservative set of assumptions, the GOA will have resources of USD 12.3 billion from its five main sources of financing: its primary fiscal surplus; debt roll-overs from the World Bank and the IADB; BCRA financing; any excess cash that the GOA may have accumulated; and new market issuance. Under a more optimistic set of assumptions (including additional Venezuelan bond purchases and additional new debt issuance), the GOA's resources could reach USD 15.3 billion. There is strong demand for GOA debt and the recent upgrade in GOA debt by S&P indicates that markets and analysts are positive about Argentina's economic fundamentals despite the GOA's unorthodox policies. President Kirchner continues to burnish his fiscal conservative credentials, and seems to understand that the fiscal surplus conserves his macroeconomic anchor. He also understands that a competitive exchange rate is a key element in sustaining the balance of payment surplus. Argentina's strong fiscal and balance of payments surpluses bode well for President Kirchner fortunes, despite an unorthodox policy approach, at least into the medium term. End Summary.

GOA debt obligations

¶3. (U) The GOA faces USD 9.5 billion in debt payments (principal and interest services) in 2006, of which USD 3.2 billion are owed to the World Bank (WB) and the Inter-American Development Bank (IADB). (Note: The GOA fully repaid its USD 9.5 billion debt to the

IMF on January 2, 2006. End Note.) The remaining debt payments include Guaranteed Loan payments of USD 1.8 billion, Boden bonds for USD 3.4 billion, Bocones (consolidated bonds) for USD 539 million and new bonds issued during the 2005 debt restructuring for USD 613 million (these are according to GOA statistics, which do not include payments due to holdouts from the 2005 restructuring).

¶4. (SBU) Debt payments may increase by up USD 800 million to a total of USD 10.3 billion when two GOA commitments made during the 2005 GOA debt restructuring are included:

- First, an estimated USD 390-400 million payment to be paid to holders of the GDP-linked coupon given to bondholders as an incentive to participate in the GOA debt exchange. (Note: All restructured bonds came with an attached option that is linked to GDP growth. This option pays 5 percent of the excess GDP growth above a trend forecast, which declines from 4.3 percent to 3.2 percent in the first nine years and stabilizes at 3 percent after 2014. End Note.) The payments are due in 2006 for growth in 2005 that exceeded the forecast.

- Second, the GOA commitment to use any excess payment capacity left from less than 100 percent participation in the debt exchange to repurchase existing performing debt or new restructured debt for six years. This excess payment capacity is estimated at approximately USD 400 million. (Note: participation in the debt exchange reached 76 percent. End Note.) The GOA has discretion to decide which bonds to repurchase and it could buy back any performing debt. In November 2005, the GOA used USD 98 million of the USD 318 million

excess capacity available for repurchases but has not made any additional repurchases since then, and it is not clear if it will repurchase any in 2006. According to press reports, the GOA may interpret its repurchase commitment to be met by its prepayment to the IMF in January 2006, since the IMF debt was performing debt as required by the exchange prospectus. However, most investors likely will be disappointed by this new interpretation of the clause and view it as a change of rules since investors expected that the GOA would repurchase Bodens or new restructured debt that would improve the performance of GOA bonds. Thus, it remains unclear whether the GOA will need to use the USD 400 million in 2006.

¶5. (U) Additionally, GOA debt payments may increase a further USD 400 million when including interest and principal amortization on Boden bonds recently issued to the Venezuelan government (GOV). The GOV has purchased USD 2.4 billion of Boden 2012 bonds since July 2005, which are not included in the latest GOA debt statistics (from June 2005, before the GOV purchases). The Boden 2012 is a USD-denominated bond which amortizes in eight equal installments of 12.5 percent each, which will increase GOA debt payments by USD 400 million in 2006. This large Boden payment comes due in August, and the GOA will need to plan ahead to ensure it has this amount available.

¶6. (SBU) The Embassy estimates that debt payments also may increase a further USD 240-300 million due to inflation (assumed at 12 percent) given that some GOA debt (most Guaranteed Loans and some Bodens and restructured debt) have CER (CPI-linked index) adjustment clauses. This would bring the GOA's debt payments to USD 11 billion.

Debts

	USD in billions
Multilaterals	3.2
Guaranteed Loans	1.8
Bodens	3.4
Bocones	0.5
Restructured bonds	0.6
Sub-Total	9.5
Additional Adjustments	
Buyback commitments	0.8
New Boden payments	0.4
Inflation adjustment	0.3
Total	11.0

Financing Sources

¶7. (U) The GOA has five main financing sources: its primary surplus; debt roll-overs by the WB and the IADB; BCRA financing; any excess cash that the GOA has accumulated; and new market issuance. The 2006 primary fiscal surplus is projected at USD 7.3 billion (3.6 percent of GDP), according to the BCRA consensus survey. This market consensus primary surplus is, however, more optimistic than the GOA 2006 budget assumption of a 3 percent of GDP primary fiscal surplus (approximately USD 5.8 billion) based on a highly conservative GDP growth rate of 4 percent - while the consensus survey is already forecasting 6.8 percent growth.

¶8. (SBU) The WB and IADB have principal amortizations of USD 1.0 billion and USD 1.4 billion, respectively. It is unclear how much the WB and the IADB may be willing to refinance this year given that there is no IMF program in place. The WB currently has on hold USD 875 million in loans to the GOA. On March 1, the IADB approved a USD 500 million adjustment loan to Argentina, the first adjustment loan it has made to without an IMF program, after having delayed its approval for two weeks. For this analysis, the Embassy assumes that the WB does not roll over its principal payments, while the IADB refinances all USD 1.4 billion in principal payments due.

¶9. (U) BCRA financing to the GOA is limited to USD 600 million, according to the limits set by the BCRA charter. (Note: The BCRA's charter allows it to provide the GOA short-term financing equal to up to 12 percent of the monetary base plus an additional 10 percent of the GOA's tax collection during the last twelve months. End Note.) The BCRA has lent the GOA USD 5.0 billion already and therefore can only lend an additional USD 600 million as of March 27. Some analysts believe that the BCRA will change its charter to allow additional borrowing from the BCRA, but we do not assume this in making our calculations. A recent Deutsche Bank report estimated GOA cash holdings at USD 2.7 billion at the beginning of 2006. This seems rather high, but we do not have any other estimates to double check this figure against.

¶10. (U) It is difficult to estimate GOA new market issuance because it depends on many factors, among them: market conditions; Venezuela's willingness to purchase more GOA debt; investment decisions by private pension funds (AFJPs); bank refinancing assumptions; and investor's appetite for GOA debt. Since the beginning of the year, the GOV has purchased USD 1.2 billion worth of GOA debt with an effective value of USD 1.0 billion. The Venezuelan Finance Minister has said several times that the GOV is willing to purchase about USD 2.5 billion, implying

another USD 1.5 billion in purchases during 2006. AFJPs may provide USD 1 billion in 2006, assuming that they receive monthly cash-flows of USD 80-100 million from contributors. According to economic consultants, new market issuance will range from a low of USD 1 billion to a maximum of USD 2.5 billion, taking into account international investors' appetite for emerging market debt, Argentina's strong fundamentals, and the scarcity of emerging market debt to debt repurchases by many countries.

¶11. (U) The Embassy excluded some financing sources which may be unlikely to materialize to make the analysis more conservative. The excluded sources are: USD 1.5 billion additional bond issuance to the GOV; USD 1.5 billion new market issuance; and USD 2.7 billion GOA cash holdings given the lack of alternative estimates. Even without those sources, the GOA's total financial resources will reach USD 12.3 billion (summarized in the table below).

Sources	USD in billions
Primary Surplus	7.3
IADB roll-over	1.4
BCRA financing	0.6
Bonds issued to Venezuela	1.0
New issues - AFJPs	1.0
New issues - other	1.0
Total	12.3

GOA issues USD 500 million of Bonars

¶12. (U) In the first week of March, Secretary of Finance Alfredo MacLaughlin traveled to New York to sound out banks about the possibility of issuing a new USD-denominated bond under U.S. law, which would be the first non-domestic GOA bond issued after the restructuring. However, the GOA decided against this attempt (at least for now) because of the risk of attachment by holdout bondholders (those who did not participate in the 2005 GOA debt exchange). Instead, the GOA decided to issue USD 500 million of Bonar (Bono de la Nacion Argentina), a new five-year USD denominated instrument under Argentine law with a fixed interest rate coupon of 7 percent and principal maturing in one installment in March 2011. In its March 22 auction, the GOA received bids for USD 726.7 million, well above the USD 500 million announced amount. The GOA accepted bids for USD 500 million at a yield of 8.36 percent, above the 7.80-8 percent yield range predicted by the market. The resolution providing for Bonar issuance allows the GOA to issue up to USD 1.5 billion of these bonds, and a new auction for another USD 500 million is expected in coming weeks. These issuances are already included in the USD 1 billion market financing and AFJP financing sources estimate in the previous section.

S&P upgrades GOA debt rating

¶13. (U) On March 23, Standard & Poor's (S&P) announced an upgrade of GOA long-term debt from B minus to B, and an upgrade to the GOA's short-term debt from C to B, both with stable outlook. According to the S&P press release, the upgrade is based on Argentina's strong growth and GOA fiscal surplus along with the reduction of GOA debt as a result of the 2005 restructuring. This upgrade may translate into lower financing costs for new GOA debt issuances.

Financial Balance

¶14. (U) The GOA's financial accounts are manageable even under conservative assumptions, with payments of USD 11 billion and resources of USD 12.3 billion and a financial surplus of USD 1.3 billion. The USD 12.3 billion in resources requires at least USD 2 billion in new debt issuance, but this seems easily achievable given that the GOA already has issued USD 500 million and is preparing to issue an additional USD 500 million in the near future. The USD 1.3 billion surplus also assumes that the IADB refinances USD 1.4 billion and the BCRA provides another USD 600 million in financing. Under an optimistic scenario, resources could reach USD 15.3 billion if Venezuela buys another USD 1.5 billion in GOA debt and the market absorbs another USD 1.5 billion in additional debt. This seems probable given the strong appetite for emerging market debt and the strong Argentine fundamentals.

Measures reducing the primary surplus do not
jeopardize GOA financial program

¶15. (SBU) The GOA has recently introduced two measures which will reduce the primary fiscal surplus. However, the fiscal impact of these measures is rather small and does not jeopardize the soundness of the GOA financial program. The two measures are:

- The increase of the minimum threshold for the income tax paid by employees, which has not been revised since the 2002 devaluation in spite of high inflation and nominal wage increases since December 2001. The minimum threshold for the income tax will be increased

from ARP 1,835 to ARP 2,400 per month for single employees, and from ARP 2,235 to ARP 3,200 per month for married employees, effective April 1. According to official estimates, this measure will have an annual fiscal cost of ARP 1.5 billion (USD 487 million) which will generate a relatively small impact on the GOA financing program. For 2006 the impact may be even smaller, only USD 365 million, because the measure is effective starting April.

- A suspension on beef exports for 180 days and an increase of export taxes on boned cuts and heat-processed beef from 5 percent to 15 percent. The aim of these measures is to increase local supply and avoid further increases in domestic beef prices. Beef prices constitute 4.5 percent of the basket of goods used to measure consumer prices, and the beef sector had resisted the GOA's demands for voluntary price restraints as part of the GOA's anti-inflation effort. According to Embassy estimates, the 180-day beef export ban will cost the GOA around ARP 184 million (USD 60 million) in lost export tax collections, not a significant loss compared to monthly tax revenues of ARP 10-11 billion. Again, this measure will not jeopardize the GOA financial program. (Note: The export ban may significantly reduce future investment in the beef sector and result in a large negative impact on export receipts in years to come. End Note.)

¶16. (U) The GOA is considering increasing the maximum amount exempt from the wealth tax, currently at ARP 102,000 (USD 33,000). The revision of this threshold has an estimated fiscal cost of ARP 300 million (USD 97 million). Even if passed, this will not significantly affect the GOA's finances this year.

Comments

¶17. (SBU) In spite of its use of price restraint agreements as an anti-inflation policy, its lack of action on structural reforms, and the much-criticized Presidential style of dealing with problems and attacking critics, President Kirchner continues to burnish his fiscal conservative credentials. The GOA continues to enjoy a strong financial position of "never spending a peso more than comes in as revenue". The expected 2006 fiscal surplus and the favorable market conditions make GOA financial needs achievable without much effort. S&P's upgrade also reflects how positive markets and analysts are on Argentine economic fundamentals despite its unorthodox policies. Kirchner appears to understand that a competitive exchange rate and orthodox public financing policies are critical to maintaining hefty surpluses in the balance of payments and the fiscal side. His strong fiscal surplus serves as an inflation anchor, and his policy initiatives, such as the increase of the minimum income tax threshold and the beef export ban, are fashioned to have minimal fiscal impact.

¶18. (U) The recent GOA Bonar auction confirms the strong market appetite for GOA debt -- despite the higher than expected yield -- and indicates that the GOA will not have any problem issuing more debt to finance its 2006 needs. Also, GOA debt payments are relatively small in 2006, in part due to the 2005 debt restructuring in which the GOA both reduced its payments and lengthened its maturities. New restructured debt accounts only for 6 percent of the USD 11 billion payments in 2006.

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